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SECURITIES AND EXCHANGE COMMISSION  
Release No. 34-79577; File No. 601-01

December 16, 2016

Euroclear Bank SA/NV; Order of the Commission Approving an Application to Modify an Existing Exemption from Clearing Agency Registration

I. Introduction

Euroclear Bank SA/NV (“EB”) filed with the Securities and Exchange Commission (“Commission”) on May 9, 2016, an application on Form CA-1 requesting to modify an existing exemption<sup>1</sup> from registration as a clearing agency (“Modification Application”)<sup>2</sup> pursuant to Section 17A<sup>3</sup> of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 17Ab2-1 thereunder.<sup>4</sup> Notice of EB’s Modification Application was published for comment in the Federal

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<sup>1</sup> See Self-Regulatory Organizations; Morgan Guaranty Trust Company of New York, Brussels Office, as Operator of the Euroclear System; Order Approving Application for Exemption From Registration as a Clearing Agency, Exchange Act Release No. 39643 (Feb. 11, 1998), 63 FR 8232 (Feb. 18, 1998) (“Original Exemption Order”); and Self-Regulatory Organizations; Morgan Guaranty Trust Company, Brussels Office, as Operator of the Euroclear System and Euroclear Bank, S.A.; Order Approving Application to Modify an Existing Exemption From Clearing Agency Registration, Exchange Act Release No. 43775 (Dec. 28, 2000), 66 FR 819 (Jan. 4, 2001) (“2001 Exemption Modification Order”) (together the “Existing Exemption”).

<sup>2</sup> The descriptions set forth in this notice regarding the structure and operations of EB have been derived primarily from information contained in EB’s amended Form CA-1 application and publicly available sources. The redacted Modification Application and non-confidential exhibits thereto are available on the Commission’s website.

<sup>3</sup> 15 U.S.C. 78q-1.

<sup>4</sup> 17 CFR 240.17Ab2-1.

Register on September 6, 2016 (“Modification Application Notice”).<sup>5</sup> The comment period closed on October 6, 2016, and the Commission received four comments, all of which were broadly supportive of the application.<sup>6</sup>

Subject to certain limitations and conditions, the Existing Exemption enables EB, as operator of the Euroclear System,<sup>7</sup> to perform the functions of a clearing agency with respect to transactions involving certain U.S. government securities<sup>8</sup> for its U.S. participants<sup>9</sup> without

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<sup>5</sup> See Euroclear Bank SA/NV; Notice of Filing of Application To Modify an Existing Exemption From Clearing Agency Registration, Exchange Act Release No. 34-78710 (Aug. 29, 2016), 81 FR 61271 (Sept. 6, 2016).

<sup>6</sup> See letters from Mark Jennis, Managing Director, DTCC (Sept. 13, 2016) (“DTCC letter”); Oscar A. Huettnner, Managing Principal, LGM Financial Consulting LLC (Sept. 12, 2016) (“LGM letter”); Charles Cascarilla, Chief Executive Officer and Co-Founder, Paxos (Oct. 6, 2016) (“Paxos letter”); Kyle Brandon, Managing Director, and Robert Toomey, Esq., Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (Oct. 6, 2016) (“SIFMA letter”).

<sup>7</sup> “Euroclear System” means the securities settlement system that has been operated by EB or its predecessor since 1968 and the assets, means, and rights related to such services. All services performed by EB that relate to securities settlement and custody are part of the Euroclear System. See Modification Application, Exhibit S-1 at 1.

<sup>8</sup> As used herein, the term “U.S. Government Securities” has the same meaning as the term “eligible U.S. government securities” used in the Existing Exemption, which consists of government securities described in Section 3(a)(42) of the Exchange Act, except that it does not include any (i) foreign-targeted U.S. government or agency securities or (ii) securities issued or guaranteed by the International Bank for Reconstruction and Development (i.e., the World Bank) or any other similar international organization, and that are (i) Fedwire-eligible U.S. government securities, (ii) mortgage-backed pass through securities that are guaranteed by the Government National Mortgage Association (“GNMA”), and (iii) any collateralized mortgage obligation whose underlying securities are Fedwire-eligible U.S. government securities or GNMA guaranteed mortgage-backed pass through securities and which are depository eligible securities. For reference purposes, Fedwire is a large-value transfer system operated by the Board of Governors of the Federal Reserve System that supports the electronic transfer of funds and of book-entry securities. See Original Exemption Order, *supra* note 1, at 8239.

<sup>9</sup> As used herein, the term “U.S. Participant” refers to any Euroclear System participant having a U.S. residence, based upon the location of its executive office or principal place of

registering as a clearing agency (“U.S. Government Securities Clearing Agency Activities”).<sup>10</sup>

The Commission originally granted the Existing Exemption in 1998 to EB’s predecessor, Morgan Guaranty Trust Company of New York, Brussels Office (“MGT-Brussels”), as operator of the Euroclear System (the Original Exemption Order).<sup>11</sup> Under the Existing Exemption, EB may provide the U.S. Government Securities Clearing Agency Activities to U.S. Participants.<sup>12</sup>

In the Modification Application, EB has requested that the Commission broaden the Existing Exemption to permit EB to perform certain additional clearing agency services (such as certain central securities depository (“CSD”) services<sup>13</sup> and collateral management services) for equity securities issued by U.S. Issuers (“U.S. Equity Securities”) for its U.S. Participants to fulfill certain collateral obligations. The Modification Application specifies these additional clearing agency functions, referred to herein as the “U.S. Equities Clearing Agency Activities,” as follows:

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business, including, without limitation, (i) a U.S. bank (as defined by Section 3(a)(6) of the Exchange Act), (ii) a foreign branch of a U.S. bank or U.S.-registered broker-dealer, and (iii) any broker-dealer registered as such with the Commission, even if such broker-dealer does not have a U.S. residence.

<sup>10</sup> See Original Exemption Order, supra note 1, at 8232.

<sup>11</sup> See supra note 1. Before EB replaced MGT-Brussels as the operator of the Euroclear System, the Commission approved a modification to the Original Exemption Order to reflect the change in control of the Euroclear System from MGT-Brussels to EB. See 2001 Exemption Modification Order, supra note 1.

<sup>12</sup> See Original Exemption Order, supra note 1, at 8239.

<sup>13</sup> As used herein, the term “CSD services” has the meaning set forth in 17 CFR 240.17Ad-22(a)(3). See Exchange Act Release No. 34-78961 (Sept. 28, 2016), 81 FR 70786, 70901 (Oct. 13, 2016) (adopting final rules that, among other things, move the definition of “central securities depository services” from Rule 17Ad-22(a)(2) to (a)(3)).

(a) the provision of clearing agency services (such as certain CSD services and collateral management services) in relation to U.S. Participants' use and reuse of U.S. Equity Securities issued by U.S. Issuers in support of collateral obligations utilizing the collateral management services provided by EB in relation to any securities or cash account held at EB that is used to receive collateral ("Collateral Accounts") in connection with the services described in (b) below and in connection with receipt and delivery from other Euroclear System participants that are users of such collateral management services provided by EB; and

(b) solely for the purpose of implementing the services described in (a) above, the provision of certain clearing agency services for U.S. Participants' receipt and delivery of U.S. Equity Securities in relation to collateral management services through accounts held at EB that are linked to EB's account held at DTC.<sup>14</sup>

EB's clearing agency functions under the U.S. Equities Clearing Agency Activities will therefore entail only the movement of U.S. Equity Securities for collateral management purposes, as opposed to the relatively broader range of clearing agency functions permitted under the U.S. Government Securities Clearing Agency Activities. For example, the U.S. Government Securities Clearing Agency Activities include the settlement of purchase and sale transactions in U.S. Government Securities as well as the movement of U.S. Government Securities for collateral management purposes.

To facilitate the movement of U.S. Equity Securities for collateral management purposes, Euroclear SA/NV ("ESA"), the parent company of EB, and The Depository Trust and Clearing Corporation ("DTCC") have entered into a joint venture known as DTCC-Euroclear Global Collateral Ltd. ("DEGCL"). As further described in Part II.D, DEGCL would provide an inventory management service ("JV-IMS") to facilitate, among other things, the repositioning and crediting of assets necessary to perform the U.S. Equities Clearing Agency Activities.

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<sup>14</sup> See Modification Application, Exhibit S-1, at 40.

EB has requested that it be permitted to provide the U.S. Equities Clearing Agency Activities without registering as a clearing agency and subject to the applicable conditions specified below. In addition, EB has requested that it be permitted to continue providing the U.S. Government Securities Clearing Agency Activities without registering as a clearing agency and under substantially the same conditions as those set forth in the Existing Exemption. After careful review of the comments received and the details and information provided in the Modification Application, the Commission concludes that it has sufficient information to decide whether the Modification Application should be approved. For the reasons discussed below, the Commission believes the Modification Application is consistent with the public interest, the protection of investors, and the purposes of Section 17A, and therefore grants EB's request to modify the Existing Exemption, subject to the conditions and limitations described further below.

## II. Summary of EB's Organization, Current Activities, and the Modification Application

### A. Organization and Supervision

EB is a limited liability company headquartered in Brussels, Belgium,<sup>15</sup> organized under the laws of Belgium, and authorized in Belgium as a Belgian credit institution. EB is an international CSD and a global provider of clearance, settlement, collateral management, and related services. In particular, EB provides its participants with a means of acquiring, holding, transferring, and pledging security entitlements by electronic book-entry on its records outside of the U.S., either free-of-payment or against payment, in multiple currencies.<sup>16</sup>

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<sup>15</sup> EB also has a secondary office in Braine l'Alleud, Belgium, branch offices in Wanchai, Hong Kong and Krakow, Poland, and a representative office in New York City. See Modification Application, Exhibit I-1.

<sup>16</sup> See Modification Application, Exhibit S-1 at 3.

EB is part of a group of companies that serve as market infrastructures by offering clearing agency services to the domestic markets in Belgium, Netherlands, France, England, Ireland, Sweden, and Finland (collectively with EB, the “Euroclear Group”).<sup>17</sup> CSD entities in the Euroclear Group are subsidiaries of ESA, a Belgian limited liability company.<sup>18</sup> Control and direction of the Euroclear Group strategic decisions are vested in ESA. ESA provides common services to EB and other affiliated companies of the Euroclear Group.<sup>19</sup> ESA maintains intercompany agreements with EB that set forth respective services and obligations.<sup>20</sup>

As previously noted, all services performed by EB that relate to securities settlement and custody are part of the Euroclear System, which is designated as a securities settlement system under the Belgian Settlement Finality Act.<sup>21</sup> According to EB, Belgian law provides for robust asset protection rights for assets deposited in the Euroclear System and for the protection of the holding of assets on the books of EB.<sup>22</sup> EB further represents that Belgian law and EB’s arrangements provide a high degree of certainty with regards to finality of transfers on EB’s

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<sup>17</sup> In 2015, the Euroclear Group had assets under custody of €27.5 trillion, turnover equivalent to €674.7 trillion, and a settlement volume of 190.7 million netted transactions. Euroclear Group’s collateral management platform, the Collateral Highway, processed collateralized transactions in 2015 for an amount of €1.068 trillion on a daily basis. See Modification Application, Exhibit S-1 at 3.

<sup>18</sup> See Modification Application, Exhibit A-2.

<sup>19</sup> See Modification Application, Exhibit S-1 at 3.

<sup>20</sup> Id.

<sup>21</sup> See Modification Application, Exhibit K-5 at 22.

<sup>22</sup> See Modification Application, Exhibit S-1 at 35.

books, the holding of collateral in accounts, the contractual framework of participants in the Euroclear System, and default procedures.<sup>23</sup>

To utilize the Euroclear System, EB participants enter into a contractual relationship with EB to open and maintain securities and cash accounts at EB.<sup>24</sup> EB participants agree that their rights to assets held in the Euroclear System are defined and governed by Belgian law.<sup>25</sup> EB states that, under Belgian law, EB generally is the beneficiary of a statutory lien on assets in accounts held at EB to secure any claim it has against EB participants arising in connection with the clearance or the settlement of transactions through, or in connection with, the Euroclear System, including claims resulting from loans or advances.<sup>26</sup>

EB represents that it is subject to consolidated supervision by the National Bank of Belgium (“NBB”) and the Belgian Financial Services Market Authority (“FSMA”).<sup>27</sup> EB also represents that NBB supervises ESA, due to its status as an authorized holding company of a

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<sup>23</sup> See Modification Application, Exhibit S-1 at 35.

<sup>24</sup> See Modification Application, Exhibit J.

<sup>25</sup> Specifically, EB represents that EB participants’ rights in securities held in the Euroclear System are defined and governed by Belgian Royal Decree No. 62 dated Nov. 10, 1967 on the Deposit of Fungible Financial Instruments and the Settlement of Transactions involving such Instruments or similar Belgian legislation. EB states that the applicable Belgian law is effectively similar to securities entitlements under Revised Article 8 of the Uniform Commercial Code. See Modification Application, Exhibit S-1 at 36.

<sup>26</sup> See Modification Application, Exhibit E-5 at 34.

<sup>27</sup> See Modification Application, Exhibit S-1 at 20.

regulated credit institution (i.e., EB) and as an institution assimilated to a securities settlement system (i.e., the Euroclear System).<sup>28</sup>

According to EB, the NBB exercises its supervision over EB and ESA on a consolidated basis.<sup>29</sup> Specifically, the NBB has prudential supervision and oversight over EB as a licensed credit institution operating in Belgium. Furthermore, the NBB supervises EB in its role as operator of the Euroclear System and as a recognized CSD. EB states that the NBB is required to ensure: (1) that EB's clearance, settlement, and payment systems operate properly; (2) that those systems are efficient and sound; and (3) that EB meets the obligations applicable to credit institutions under applicable European law, as adopted into Belgian law.<sup>30</sup> EB represents that the NBB has the authority to order EB to limit, suspend, or stop activities if EB does not comply with the regulatory requirements of its various authorizations.<sup>31</sup> EB also states that the NBB assesses EB under the *Principles for Financial Market Infrastructures* ("PFMI") and considers best practices where appropriate.<sup>32</sup>

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<sup>28</sup> See Modification Application, Exhibit S-1 at 20. According to EB, pursuant to Article 20, § 2 of the Belgian Royal Decree of September 26, 2005, institutions assimilated to a settlement institution may not have shareholdings in commercial companies without the prior approval of the NBB, unless the shareholding is taken in companies whose activities consist, in whole or in part, in the activities that a settlement institution or an institution assimilated thereto may carry out.

<sup>29</sup> Id. In addition, EB is submitted to the Regulation 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms (CRR) IV, and Regulation 909/2014 of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories (CSDR). See Modification Application, Exhibit K-5 at 16.

<sup>30</sup> See Modification Application, Exhibit S-1 at 20.

<sup>31</sup> Id.

<sup>32</sup> See Modification Application, Exhibit S-1 at 20. The PFMI are standards applicable to financial market infrastructures, such as CSDs and securities settlement systems. Committee on

EB further represents that the FSMA regulates EB for the purposes of compliance with investor protection rules and rules on the operation, integrity, and transparency of the Belgian financial markets.<sup>33</sup> These include requirements relating to conflicts of interest with clients, customer protection in case of insolvencies, and enforcement of conduct requirements.

B. Current Activities

The Existing Exemption permits EB to provide the U.S. Government Securities Clearing Agency Activities to U.S. Participants.<sup>34</sup> Under the terms of the Existing Exemption, the Commission places a limit on the volume of transactions in U.S. Government Securities conducted by U.S. Participants that can be settled through the Euroclear System. Specifically, the average daily volume of U.S. Government Securities settled through the Euroclear System for U.S. Participants may not exceed five percent of the total average daily dollar value of the aggregate volume in U.S. Government Securities.<sup>35</sup> To facilitate the monitoring of compliance with the volume limit and the impact of EB's operations on the U.S. Government Securities market under the Existing Exemption, EB is required to provide the Commission with quarterly reports, calculated on a twelve-month rolling basis, of (i) the average daily volume of transactions in eligible U.S. Government Securities for U.S. Participants that are subject to the

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Payment and Settlement Systems (now the Committee on Payment and Market Infrastructure) and Technical Committee of the International Organization of Securities Commissions, Principles for financial market infrastructures (Apr. 16, 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

<sup>33</sup> See Modification Application, Exhibit S-1 at 20–21.

<sup>34</sup> See Original Exemption Order, supra note 1, at 8239.

<sup>35</sup> See id. at 8239.

volume limit and (ii) the average daily volume of transactions in eligible U.S. Government Securities for all Euroclear System participants, whether or not subject to the volume limit.<sup>36</sup> EB is also required to notify the Commission regarding material adverse changes in any account maintained in the Euroclear System for U.S. Participants.<sup>37</sup> In addition, EB is required to respond to Commission requests for information regarding any U.S. Participant about whom the Commission has financial solvency concerns, including, for example, a settlement default by a U.S. Participant.<sup>38</sup> The Commission also requires a satisfactory memorandum of understanding with the Belgian banking and securities regulator (currently the NBB) to facilitate the provision of information by EB to the Commission.<sup>39</sup>

EB participants are able to utilize various clearance and settlement services through the Euroclear System.<sup>40</sup> Among those services are the EB collateral management services (“EB-CMS”), which provide a framework for exchanging collateral to fulfill bilateral obligations

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<sup>36</sup> See Original Exemption Order, supra note 1, at 8240. EB’s non-U.S. participants are not subject to any restrictions under the Existing Exemption.

<sup>37</sup> For purposes of the Original Exemption Order, the term “material adverse changes” included (i) the termination of any U.S. Participant; (ii) the liquidation of any securities collateral pledged by a U.S. Participant to secure an extension of credit made through the Euroclear System; (iii) the institution of any proceedings to have a U.S. Participant declared insolvent or bankrupt; or (iv) the disruption or failure in whole or in part in the operations of the Euroclear System either at its regular operating location or at its contingency center. See Original Exemption Order, supra note 1, at 8240, n.78.

<sup>38</sup> See Original Exemption Order, supra note 1, at 8240.

<sup>39</sup> See 2001 Exemption Modification Order, supra note 1, at 821; see also Understanding Regarding an Application of Euroclear Bank for an Exemption Under U.S. Federal Securities Laws (January, 30, 2001) available at [https://www.nbb.be/doc/cp/nl/aboutcbfa/mou/pdf/mou\\_2001-01-30\\_euroclearbank.pdf](https://www.nbb.be/doc/cp/nl/aboutcbfa/mou/pdf/mou_2001-01-30_euroclearbank.pdf).

<sup>40</sup> See Modification Application, Ex. J.

between counterparties.<sup>41</sup> Parties to bilateral arrangements that require the posting of collateral by one party (“Collateral Giver”) in favor of the other party (“Collateral Taker”) may use the EB-CMS to secure credit exposures arising under such bilateral arrangements. The terms of such bilateral arrangements and related collateral needs (including the credit exposure, collateral requirements, and collateral terms) are negotiated and agreed between the parties independently of EB. After such arrangements are agreed, the parties then enter into an agreement with EB to provide the EB-CMS.

EB states that its non-U.S. participants use the EB-CMS to meet collateral obligations with a variety of assets, including U.S. Government Securities and U.S. Equity Securities.<sup>42</sup> EB also represents that U.S. Participants currently use the EB-CMS to meet collateral obligations with a wide variety of assets including U.S. Government Securities, but not including U.S. Equity Securities, as EB prohibits U.S. Participants from holding U.S. Equity Securities in an account at EB for any purpose as part of its contractual documentation with its participants, consistent with the terms of the Existing Exemption (“Current Equities Restrictions”).<sup>43</sup> EB represents that automated systems protocols and control procedures are implemented in the Euroclear System to enforce the Current Equities Restrictions. The systems protocols consist of

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<sup>41</sup> See Modification Application, Ex. S-1 at 3.

<sup>42</sup> See Modification Application, Exhibit S-1 at 34.

<sup>43</sup> Id. EB’s customer contracts provide that: “Due to restrictions imposed on Euroclear Bank by the United States Securities and Exchange Commission (S.E.C.) following SEC Rule 17Ab2-1, equities, ETFs and REITs issued by companies incorporated in a state or territory of the United States can be held in Euroclear Bank by non-US Participants only.” See Modification Application, Exhibit S-1 at 6.

coded validation rules that are part of EB’s fully automated and standard processes that run prior to the settlement of any securities movement to or from an account held at EB.<sup>44</sup>

C. Modification Application

EB has requested that the Commission broaden the Existing Exemption to allow it to provide the EB-CMS to its U.S. Participants using U.S. Equity Securities. Specifically, EB has requested that the Commission: (1) continue the Existing Exemption under substantially similar conditions except as otherwise specified herein, (2) broaden the Existing Exemption to allow EB to provide the U.S. Equities Clearing Agency Activities under new conditions applicable to those activities, and (3) apply conditions to EB that are largely harmonized between the U.S. Government Securities Clearing Agency Activities and U.S. Equities Clearing Agency Activities (collectively, the “Clearing Agency Activities”).<sup>45</sup> Below the Commission discusses each of these requests in turn.

First, EB has requested that the Commission continue the Existing Exemption to conduct the U.S. Government Securities Clearing Agency Activities without: (i) requiring EB to register as a clearing agency with the Commission; (ii) changing the definition of the terms U.S. Government Securities or U.S. Participants, as set forth in the Existing Exemption; or (iii) changing the conditions set forth in the Existing Exemption with regards to the U.S. Government Securities Clearing Agency Activities, listed below:

(a) Volume Limit. The average daily volume of transactions in eligible U.S. Government Securities for U.S. Participants

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<sup>44</sup> See Modification Application, Exhibit S-1 at 34.

<sup>45</sup> In harmonizing the conditions between the Clearing Agency Activities, new operational risk conditions, set forth in Part 0, and certain additional other conditions, set forth in Part 0, would also apply to the U.S. Government Securities Clearing Agency Activities.

processed through EB as operator of the Euroclear System may not exceed five percent of the total average daily dollar value of the aggregate volume in eligible U.S. Government Securities.

(b) Commission Access to Information regarding U.S. Government Securities Clearing Agency Activities. EB will continue to provide the Commission with quarterly reports, calculated on a twelve-month rolling basis, of (a) the average daily volume of transactions in eligible U.S. Government Securities for U.S. Participants that are subject to the volume limit as described in Section IV.C.2 of the Original Exemption Order and (b) the average daily volume of transactions in eligible government securities for all Euroclear System participants, whether or not subject to the volume limit as described in Section IV.C.2 of the Original Exemption Order.<sup>46</sup>

Second, EB has requested that the following conditions of the Existing Exemption with regards to the U.S. Government Securities Clearing Agency Activities be replaced and superseded:

(a) the obligations in Section IV.C.3 of the Original Exemption Order to provide disclosure documents to the Commission;

(b) the obligations in Section IV.C.3 of the Original Exemption Order to file with the Commission amendments to its application for exemption on Form CA-1; and

(c) the obligations in Section IV.C.3 of the Original Exemption Order to notify the Commission regarding material adverse changes in any account maintained by Euroclear for its U.S. Participants and to respond to a Commission request for information about any U.S. Participant about whom the Commission has financial solvency concerns.<sup>47</sup>

The conditions set forth in Part IV.D would replace the above and include, among other things, substantially similar obligations to the above.

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<sup>46</sup> See Modification Application, Exhibit S-1 at 39.

<sup>47</sup> See id.

Third, EB has requested that the Commission permit EB to provide, without registering as a clearing agency with the Commission, the U.S. Equities Clearing Agency Activities, subject to certain conditions. As described in the Modification Application, EB's provision of U.S. Equities Clearing Agency Activities would entail activities such as custody and safekeeping,<sup>48</sup> settlement,<sup>49</sup> and asset servicing<sup>50</sup> on behalf of U.S. Participants with respect to U.S. Equity Securities. For example, EB would maintain securities accounts on its books,<sup>51</sup> provide safekeeping of and recordkeeping for those securities accounts,<sup>52</sup> settle instructions by participants,<sup>53</sup> and provide recordkeeping and reporting in real time on the status of settlement to participants.<sup>54</sup> EB also would process corporate actions as part of its asset servicing business for any U.S. Equity Securities that remain in EB's account held at DTC on the record date.<sup>55</sup>

The EB-CMS would be offered to U.S. Participants in support of their obligations under security-based swap transactions, securities lending transactions, and repurchase agreements, among other transactions.<sup>56</sup> The EB-CMS would independently verify that the collateral

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<sup>48</sup> See Modification Application, Exhibit S-1 at 4.

<sup>49</sup> See Modification Application, Exhibit S-1 at 5.

<sup>50</sup> See Modification Application, Exhibit S-1 at J-3.

<sup>51</sup> See Modification Application, Exhibit S-1 at 2.

<sup>52</sup> See Modification Application, Exhibit K-5 at 80–81.

<sup>53</sup> See Modification Application, Exhibit K-5 at 76, 83.

<sup>54</sup> See Modification Application, Exhibit K-5 at 76.

<sup>55</sup> See Modification Application, Exhibit J-3.

<sup>56</sup> See, e.g., Modification Application, Exhibit P-2 (describing necessary revisions to its Operating Procedures related to collateral services, derivatives services, loan services,

proposed and provided by the Collateral Giver meets the terms reported by the counterparties for the duration of the collateral obligation.<sup>57</sup> EB would do this by calculating the exchange of value necessary to meet the collateral obligation information entered in by the users of the EB-CMS, including by making value determinations, such as marking to market the value of the collateral based on reference data.<sup>58</sup> Also, EB would generate instructions and communicate the instructions to EB's settlement processing infrastructure to transfer collateral among the Collateral Accounts.<sup>59</sup> Under the Existing Exemption, EB may already offer the EB-CMS for U.S. Government Securities to U.S. Participants, but EB may only offer the EB-CMS for U.S. Equity Securities to its non-U.S. participants, because non-U.S. participants are not covered by the scope of the Existing Exemption.

#### D. Collateral Regulations and Related Infrastructure

According to the Modification Application, new and enhanced regulatory requirements ("New Collateral Regulations") are leading counterparties to derivative and financing transactions to seek streamlined margin processing and increased efficiency in the availability

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repurchase services, and securities lending services arising out of the proposed U.S. Equities Clearing Agency Activities).

<sup>57</sup> See Modification Application, Exhibit J-3.

<sup>58</sup> See Modification Application, Exhibit K-5 at 60 (referencing obtaining the market value of a security. The EB-CMS system does not apply any further haircuts or adjustments once the market value is obtained from third party data providers); see also Euroclear plc, Risk Management at Euroclear: Including Pillar 3 Disclosure 2012 – Euroclear plc, at 43 (2012) ("Securities for which Euroclear Bank does not obtain external quotations regularly can also be valued according to the price associated with securities transactions in the Euroclear system, or according to theoretical models."), available at [https://www.euroclear.com/dam/Brochures/Pillar3\\_2012.pdf](https://www.euroclear.com/dam/Brochures/Pillar3_2012.pdf).

<sup>59</sup> See Modification Application, Exhibit J-3.

and deployment of collateral.<sup>60</sup> These New Collateral Regulations are expected to be implemented in the European Union in the near future.<sup>61</sup> EB states that the regulatory changes include new restrictions on eligible collateral, requiring the use of highly liquid assets, prescribed haircuts, and segregation requirements, as well as a prohibition on rehypothecation for initial margin. EB believes that, when fully implemented, the New Collateral Regulations will result in increased capital requirements, mandatory central clearing of more derivative transactions, and new margining rules for bilateral trades, which will increase demand for high quality collateral. EB projects that the requirement for more transactions and exposures to be collateralized globally will result in a significant increase in the number of required collateral movements between market participants, which will have implications for counterparty credit risk, funding and capital charges, and reputational and operational risk.

EB also represents that these regulatory changes include requirements for initial margin for counterparties to certain derivative and financing transactions, as well as a reduction or removal of unsecured thresholds for variation margin. EB expects that these new initial margin requirements will significantly increase the amount of collateral required to support a number of derivative and financing transactions. In addition, EB represents that it is expected that the removal or reduction of unsecured thresholds for variation margin will mean any changes in

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<sup>60</sup> See Modification Application, Exhibit S-1 at 6.

<sup>61</sup> Id.; see also Peter Madigan, EU non-cleared margin regime set to take effect in January 2017, Risk.net (Sept. 27, 2016) (regarding the adoption and implementation of the draft Regulatory Technical Standards on risk mitigation techniques for non-centrally cleared OTC derivatives), available at <http://www.risk.net/risk-magazine/news/2472246/eu-non-cleared-margin-regime-set-to-take-effect-in-january-2017>.

underlying transaction valuations may trigger increased margin calls, requiring market participants to hold additional collateral available for posting.

EB represents that the New Collateral Regulations therefore are expected to greatly increase the complexity of collateral management and create new competition for collateral.<sup>62</sup> Industry research cited by EB indicates that as these regulatory changes take effect, the volume of required collateral movements will increase and the number of collateral settlement fails and associated costs are likely to rise proportionally.<sup>63</sup> EB has requested to broaden its exempt clearing agency activities for the purpose of assisting its participants' compliance with these regulations, which, as stated earlier, are scheduled to take effect in the near future and which will significantly affect the use of collateral. In connection with its request, EB has taken preparatory measures to create the infrastructure necessary to accommodate the U.S. Equities Clearing Agency Activities, including the formation in 2014 of DEGCL, the joint venture between Euroclear and DTCC. DEGCL describes itself as an open architecture infrastructure designed to streamline collateral processing globally, providing solutions for both over-the-counter derivatives and financing that deliver transparency, collateral mobility, efficiency, and security

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<sup>62</sup> EB states that collateral movements will need to be tracked and applied against a growing number and type of credit support documentation, while segregation rules will multiply the number of collateral accounts needed and correspondingly increase the complexity of accurately processing collateral movements across account types, fragmented central clearing, and collateral delivery channels. See Modification Application, Exhibit S-1 at 7; see also Implications of Collateral Settlement Fails: An Industry Perspective on Bilateral OTC Derivatives (Feb. 2016), available at [http://www.imas.org.sg/uploads/media/2016/03/03/1046\\_Implications\\_of\\_Collateral\\_Settlement\\_Fails\\_FINAL.pdf](http://www.imas.org.sg/uploads/media/2016/03/03/1046_Implications_of_Collateral_Settlement_Fails_FINAL.pdf) (“Implications of Collateral Settlement Fails”); Collateral Management in Europe: Searching for Central Intelligence (May 2015), available at <https://www.euroclear.com/dam/Brochures/Euroclear-Collateral-Management-Aite-Paper.pdf>; The Economics of Collateral (Dec. 2013), available at <http://dtcc.com/~media/Files/Downloads/WhitePapers/LSE%20Report.ashx>.

<sup>63</sup> See, e.g., Implications of Collateral Settlement Fails, supra note 62, at 5.

through its utility offerings.<sup>64</sup> DEGCL is authorized as a service company by the Financial Conduct Authority (“FCA”) in the United Kingdom.<sup>65</sup> EB represents that DEGCL seeks to provide services to its users, including buy-side and sell-side financial institutions, in meeting their risk management and regulatory requirements for the holding and exchange of collateral as required by the New Collateral Regulations.<sup>66</sup> These services will be offered to users located primarily in Europe and the U.S.<sup>67</sup>

With respect to the U.S. Equities Clearing Agency Activities, DEGCL will facilitate a U.S. Participant’s repositioning of assets in U.S. Participant-held accounts at The Depository Trust Company (“DTC”) for use in the U.S. Participant’s corresponding Collateral Account at EB in the EB-CMS. In particular, these activities will be provided by the JV-IMS, a DEGCL service offering that, according to DEGCL, will automate certain collateral management tasks, reposition inventory across settlement locations in the U.S. and Europe, and thereby make collateral more readily available.<sup>68</sup> EB represents that the JV-IMS would provide an automated mechanism for an entity that is both a participant of EB and DTC (“JV-IMS User”)<sup>69</sup> to receive

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<sup>64</sup> See “State street to pilot GlobalCollateral ltd’s margin settlement messaging service,” DEGCL Press Release (July 11, 2016), available at <http://www.globalcollateral.net/press5-statestreet.html>.

<sup>65</sup> DEGCL’s reference number as an authorized service company is 686269. See FCA Financial Services Register, available at <https://www.fca.org.uk/register>.

<sup>66</sup> See Modification Application, Exhibit S-1 at 7.

<sup>67</sup> See id.

<sup>68</sup> See Modification Application, Exhibit S-1 at 8; “State street to pilot GlobalCollateral ltd’s margin settlement messaging service,” DEGCL Press Release (July 11, 2016), available at: <http://www.globalcollateral.net/press5-statestreet.html>.

<sup>69</sup> See id.

recommendations on how to reposition assets in the JV-IMS User's account held at DTC, including U.S. Equity Securities, for subsequent crediting of those assets to its Collateral Accounts within the EB-CMS (and for the return of such assets to the JV-IMS User's account held at DTC). To facilitate the JV-IMS, EB will become a participant at DTC, subject to approval by DTC, its standard membership requirements and certain heightened requirements for a non-U.S. entity.<sup>70</sup>

To initially establish its sub-account held at DTC for the JV-IMS prior to its initial use, a JV-IMS User will set parameters that specify which types of assets in its account held at DTC (and in what amounts) it will make available for the JV-IMS, including any limits or criteria on those assets (such as ratings).<sup>71</sup> The JV-IMS User will then transfer assets that meet the parameters to a sub-account held at DTC that is designated for, and dedicated to, the JV-IMS. The JV-IMS will then monitor that information and independently verify that the assets identified by the JV-IMS User meet its own parameters, as well as the EB eligibility requirements (such as an accepted CUSIP number). If so, the JV-IMS will prepare and submit to EB free-of-payment delivery instructions (which EB will in turn submit to DTC on the JV-IMS User's behalf) to transfer the assets identified by the JV-IMS User in its designated sub-account held at DTC to EB's account held at DTC.<sup>72</sup> The JV-IMS will also prepare and submit

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<sup>70</sup> EB has signed a DTC Participant's Agreement pursuant to which it agreed that the DTC rules shall be a part of the terms and conditions of every contract or transaction that EB may make or have with DTC. See id.; see also DTC Policy Statements on the Admission of Participants (June 2013).

<sup>71</sup> See Modification Application, Exhibit S-1 at 8.

<sup>72</sup> This process is subject to DTC rules governing EB's role in repositioning assets. See Self-Regulatory Organizations; The Depository Trust Company; Order Approving Proposed

instructions to EB to credit such transferred assets from EB's account held at DTC to the relevant JV-IMS User's Collateral Accounts.

Additionally, the JV-IMS would facilitate the automated return of such assets to the JV-IMS User's account held at DTC when necessary to meet other settlement obligations and for corporate actions by preparing and submitting to EB (for eventual forwarding by EB to DTC) free-of-payment delivery instructions to transfer such assets from EB's account held at DTC to the relevant JV-IMS User's sub-account held at DTC. Finally, the JV-IMS would report to the JV-IMS User all settlement instructions generated via the JV-IMS, the status of the generated settlement instructions, and other relevant information in regards to such settlement instructions. All of the foregoing would be subject to the DTC rules regarding a link with EB that was approved by the Commission in July 2016.<sup>73</sup>

After the JV-IMS User's assets are credited to EB's account held at DTC via the JV-IMS processes described above, the assets would then be credited to the Collateral Accounts for the relevant EB participant.<sup>74</sup> As stated above, with respect to the U.S. Equities Clearing Agency Activities, EB's internal protocols would structure these Collateral Accounts to allow U.S. Participants to: (1) take receipt of U.S. Equity Securities credited to the account via the JV-IMS process described immediately above; (2) deliver U.S. Equity Securities out of the Collateral

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Rule Change to Establish a Link with Euroclear, Exchange Act Release No. 78358 (July 19, 2016), 81 FR 48482 (July 25, 2016) ("DTC EB Link Rule").

<sup>73</sup> See id.

<sup>74</sup> All settlement activity related to the JV-IMS that occurs on the books of DTC is governed exclusively by DTC procedures. All activity related to the use of assets that occurs on the books of EB is governed exclusively by the EB contractual framework. See Modification Application, Exhibit S-1 at 9.

Accounts for mobilization as collateral through the EB-CMS infrastructure and to receive U.S. Equity Securities into the Collateral Accounts mobilized from other participants of the EB-CMS; and (3) deliver U.S. Equity Securities back to the relevant JV-IMS User's sub-account at DTC. EB represents that these transfer and use restrictions on Collateral Accounts would prevent a U.S. Participant's U.S. Equity Securities held in Collateral Accounts from being used for any other purposes in the Euroclear System, such as normal settlement activity, except under certain circumstances involving the default of a Collateral Giver.<sup>75</sup>

Currently, non-U.S. JV-IMS Users may move U.S. Equity Securities from DTC to EB by transferring the securities to an account held at DTC for EB's custodian. Approving the Modification Application would expand the options available to non-U.S. participants, such that non-U.S. JV-IMS Users holding U.S. Equity Securities at DTC could also transfer U.S. Equity Securities to EB's DTC account. If a user of the EB-CMS defaults, either a Collateral Taker or a Collateral Giver can notify EB of a default under their bilateral transaction. EB's operations staff would then initiate a process to override the regular controls that govern use of U.S. Equity Securities as collateral and would instruct DTC to debit those securities from EB's DTC Account and to credit them to the account held at DTC for EB's custodian, while still being credited to the non-defaulting party's account at EB.<sup>76</sup>

In the Modification Application, EB has proposed to amend the Current Equities Restrictions<sup>77</sup> to permit the use by U.S. Participants of U.S. Equity Securities subject to the

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<sup>75</sup> See Modification Application, Exhibit S-1 at 11.

<sup>76</sup> Id.

<sup>77</sup> See supra Part 0.

transfer and use restrictions described above. In all other circumstances, the Current Equities Restrictions would otherwise remain applicable.

### III. Discussion

#### A. Statutory Standards

Section 17A of the Exchange Act directs the Commission to facilitate the establishment of (i) a national system for the prompt and accurate clearance and settlement of securities transactions and (ii) linked or coordinated facilities for clearance and settlement of securities transactions.<sup>78</sup> In facilitating the establishment of the national clearance and settlement system, the Commission must have due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents.<sup>79</sup> Section 17A(b)(1) of the Exchange Act requires all clearing agencies to register with the Commission.<sup>80</sup> It also states that, upon the Commission's motion or upon a clearing agency's application, the Commission may conditionally or unconditionally exempt a clearing agency from any provision of Section 17A of the Exchange Act or the rules or regulations thereunder if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of Section 17A, including the prompt and accurate clearance and settlement of securities and funds.<sup>81</sup> The Commission notes that it has previously found an exemption from clearing agency

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<sup>78</sup> See 15 U.S.C. 78q-1(a)(2).

<sup>79</sup> See 15 U.S.C. 78q-1(a)(2)(A).

<sup>80</sup> See 15 U.S.C. 78q-1(b); 17 CFR 240.17Ab2-1.

<sup>81</sup> See 15 U.S.C. 78q-1(b)(1).

registration under Section 17A(b)(1) to be an appropriate response in instances where an entity has engaged in a limited scope of clearing agency activity.<sup>82</sup>

B. Comments Received

The Commission received four comment letters in response to the Modification Application Notice.<sup>83</sup> Commenters included U.S. market participants and an industry representative. Among the commenters was DTCC, which is the holding company for three clearing agencies registered with the Commission and co-owner of DEGCL. All of the commenters expressed support for the Modification Application.

Each of the commenters stated that the proposed broadening of EB's exempted clearing agency activity would benefit U.S. market participants. One commenter stated that the Modification Application would provide U.S. market participants with more options to meet collateral and liquidity demands by providing access to an expanded pool of high quality collateral.<sup>84</sup> The commenter further explained that the use of U.S. Equity Securities as collateral by non-U.S. participants is common in the European Union, and the Modification Application would help provide a level playing field between U.S. Participants and non-U.S. participants in the types of U.S. securities that can be offered as collateral in the EB-CMS.<sup>85</sup> Another commenter noted that the U.S. Equities Clearing Agency Activities would enable U.S. market

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<sup>82</sup> See Modification Application Notice, supra note 5, at 61277.

<sup>83</sup> See supra note 6.

<sup>84</sup> See SIFMA letter at 2 (also noting that the Modification Application would improve asset mobility for U.S. banks and broker-dealers engaging in securities financing transactions); see also LGM letter at 1 (stating that U.S. institutions would significantly benefit from being allowed to use U.S. Equity Securities as collateral in the international environment).

<sup>85</sup> See SIFMA letter at 2.

participants to optimize their management of U.S. Equity Securities inventory by effectively and efficiently addressing collateral management needs in other markets and time zones.<sup>86</sup> Several commenters also stated that expanding the scope of activity under the Existing Exemption to include U.S. Equity Securities would result in lower costs for U.S. market participants and more efficient capital management.<sup>87</sup>

Each of the commenters also stated that the U.S. Equities Clearing Agency Activities would reduce risk. One commenter stated that the Modification Application would reduce systemic risk by supporting more efficient allocation of collateral, thus reducing transaction costs and the risk of settlement failures.<sup>88</sup> Another commenter stated that the effective management of collateral inventory on a real-time basis, as described in the Modification Application, would reduce operational risk and increase efficiency.<sup>89</sup> A third commenter stated that allowing U.S. Participants to use U.S. Equity Securities in the EB-CMS would reduce settlement and liquidity risks across the broader securities markets.<sup>90</sup>

In addition, the commenters more generally endorsed the Modification Application based on EB's reputation as a market infrastructure provider.<sup>91</sup> One commenter explained that EB

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<sup>86</sup> See Paxos letter at 2–3; see also DTCC letter at 3 (stating that the Modification Application would provide U.S. participants with the ability to optimize collateral globally).

<sup>87</sup> See SIFMA letter at 2; DTCC letter at 3; Paxos letter at 3;

<sup>88</sup> See SIFMA letter at 3; see also DTCC letter at 3 (stating that the JV-IMS will reduce systemic risk by supporting the more efficient allocation of collateral, reducing transaction costs and the risk of settlement failures.).

<sup>89</sup> See Paxos letter at 2.

<sup>90</sup> See LGM letter at 1.

<sup>91</sup> See DTCC letter at 3; Paxos letter at 1; SIFMA letter at 3.

provides its participants with an efficient means of acquiring, holding, transferring, and pledging security entitlements by electronic book entry on its records outside the U.S., either free of or versus payment, in multiple currencies.<sup>92</sup> Commenters also noted more generally that EB is well-known and well-regulated,<sup>93</sup> and that it operates in a manner consistent with the PFMI.<sup>94</sup>

Finally, one commenter expressed views regarding the specific terms and conditions in the Modification Application Notice. The commenter expressed a favorable view of the Modification Application, stating that, given the limited scope of the modification request, and in light of the increased transparency that would result from the additional monitoring, reporting, and other conditions proposed by EB in the Modification Application, the Commission should consider EB compliant with applicable regulatory standards.<sup>95</sup> The commenter also requested that the Commission use the proposed reporting conditions to monitor the growth of the U.S. Equities Clearing Agency Activities rather than establish a fixed volume limit at this time, noting that the proposed reporting conditions would provide the Commission with greater transparency and broader visibility into cross-border collateral management.<sup>96</sup> In addition, the commenter stated that it did not see other providers being disadvantaged by an expansion of EB's exempted activity.<sup>97</sup>

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<sup>92</sup> See Paxos letter at 1.

<sup>93</sup> See LGM letter at 2–3.

<sup>94</sup> See DTCC letter at 3; Paxos letter at 1; SIFMA letter at 3.

<sup>95</sup> See Paxos letter at 1–2.

<sup>96</sup> See id.

<sup>97</sup> See id.

C. Evaluation of the Modification Application

With respect to the U.S. Government Securities Clearing Agency Activities, the Modification Application does not propose to make any material changes to the U.S. Government Securities Clearing Agency Activities, and therefore the Commission is not reconsidering the appropriateness of an exemption for those activities in this order. In addition, EB has represented in the Modification Application that it continues to meet the standards previously applied when the Commission approved the Existing Exemption,<sup>98</sup> and for the purposes of its consideration of the Modification Application, the Commission is taking those representations into account.<sup>99</sup>

With respect to the U.S. Equities Clearing Agency Activities, the Commission believes that, while such activities reflect an expansion of the range of securities for which EB may perform clearing agency functions relative to the Existing Exemption, those additional clearing agency functions would remain limited because EB would necessarily rely on its link with DTC to perform them. For example, the Modification Application requests only that EB be permitted to settle collateral movements involving U.S. Equity Securities and that the settlement of those collateral movements occur through the use of dedicated accounts at EB and DTC structured so that a U.S. Participant can only: (i) receive U.S. Equity Securities in these accounts; (ii) deliver U.S. Equity Securities out of these accounts for mobilization as collateral in the EB infrastructure; and (iii) deliver U.S. Equity Securities back to the relevant user's account at DTC.<sup>100</sup> The

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<sup>98</sup> See Modification Application, Exhibit S-1 at 13.

<sup>99</sup> The Commission also notes that it has no basis to believe that EB has not operated within and otherwise performed in accordance with the terms and conditions of the Existing Exemption.

<sup>100</sup> See Modification Application, Exhibit S-1, at 9-10.

Modification Application does not request that EB be permitted to provide the full range of CSD and securities settlement activities for the purchase or sale of such securities. Finally, the Commission believes that the terms and conditions of the exemption set forth in this order would, as noted by one of the commenters,<sup>101</sup> assist the Commission in evaluating and monitoring the U.S. Equities Clearing Agency Activities on an ongoing basis to assess, among other considerations, how such limited activity interacts with other aspects of the national clearance and settlement system and whether the exemption and its conditions remain appropriate. Accordingly, the Commission believes that an exemption subject to the terms and conditions set forth herein, rather than full registration as a clearing agency, continues to be the appropriate regulatory status for EB.

Below, the Commission evaluates EB's request for an exemption from registration as a clearing agency for the U.S. Equities Clearing Agency Activities under Section 17A(b)(1) of the Exchange Act, including whether the Modification Application is consistent with the public interest, the protection of investors, and the purposes of Section 17A of the Exchange Act. The Commission also describes the specific conditions that will be imposed in connection with the approval of EB's request for an exemption and explains its rationale for such conditions.

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<sup>101</sup> See Paxos letter at 3 (responding to a request for comment in the Modification Application Notice regarding whether the Commission should include among the conditions for the U.S. Equities Clearing Agency Activities a volume limit similar to the volume limit under the Existing Exemption that applies to the U.S. Government Securities Clearing Agency Activities and stating that a fixed volume limit should not be added as a condition). The Commission does not believe that such a condition is necessary and has declined to include it.

1. Facilitating the Establishment of Linked or Coordinated Facilities for the Settlement of Transactions

Congress found that the linking of settlement facilities and the development of uniform standards and procedures for settlement will reduce unnecessary costs and increase the protection of investors, and directed the Commission to use its authority to facilitate the establishment of linked or coordinated facilities for settlement of transactions in securities.<sup>102</sup> As previously described, EB will perform the U.S. Equities Clearing Agency Activities using settlement facilities linked between DTC, a clearing agency registered with the Commission, and EB.<sup>103</sup> For the reasons discussed in the Modification Application Notice and as discussed further below, the Commission believes that links and coordination between these two settlement providers will foster the establishment of uniform standards and procedures, which in turn may result in benefits to participants of both DTC and EB resulting from such standardization.

Commenters generally agreed that the proposed link between EB and DTC would provide benefits to U.S. market participants. One commenter explained that the U.S. Equities Clearing Agency Activities could help U.S. market participants optimize the management of their U.S. Equity Securities inventory by efficiently addressing management needs in other markets and time zones.<sup>104</sup> Another commenter stated that adding the ability to reposition equity assets held at DTC for transactions on the books at EB would provide common participants of

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<sup>102</sup> See 15 U.S.C. 78q-1(a)(1)(D), (a)(2)(A)(ii).

<sup>103</sup> See Self-Regulatory Organizations; The Depository Trust Company; Order Approving Proposed Rule Change to Establish a Link with Euroclear, Exchange Act Release No. 34-78358 (July 19, 2016), 81 FR 48482 (July 25, 2016).

<sup>104</sup> See Paxos letter at 2.

DTC and EB with the ability to optimize collateral globally, reduce costs, and manage their balance sheets in a capital efficient manner.<sup>105</sup> The Commission agrees that the greater coordination among settlement providers in performing the U.S. Equities Clearing Agency Activities is consistent with the public interest because it could facilitate improved asset mobilization generally, benefiting U.S. market participants.

2. Safeguarding Securities and Funds Related to the Settlement of Securities Transactions

Congress found that the safeguarding of securities and funds related to the settlement of securities transactions is necessary for the protection of investors, and directed the Commission to have due regard for the safeguarding of securities and funds in the use of its authority under Section 17A of the Exchange Act.<sup>106</sup> Accordingly, the Commission has reviewed EB's representations with respect to its rules, procedures, and controls on the rights of securities issuers and holders; the creation of securities positions within client accounts; the regular review of such procedures and controls by EB's internal audit department and external auditor; the enterprise risk management framework EB operates under; and the role that DTC will play as a depository for U.S. Equity Securities. As discussed in the Modification Application Notice, the Commission has adopted rules under Section 17A of the Exchange Act that, among other things, help facilitate the safeguarding of funds and securities by registered clearing agencies.<sup>107</sup> For

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<sup>105</sup> See DTCC letter at 3.

<sup>106</sup> See 15 U.S.C. 78q-1(a)(1)(A), (2)(A).

<sup>107</sup> See 12 CFR 240.17Ad-22(d); 12 CFR 242.1000 *et seq.*; see also 12 CFR 240.17Ad-22(e) (adopted subsequent to publication of the Modification Application Notice with a compliance date of April 11, 2017).

example, the Commission's rules require certain registered clearing agencies to have policies and procedures to, among other things, immobilize or dematerialize securities certificates and transfer them by book entry to the greatest extent possible; eliminate principal risk by linking securities transfers to funds transfers; identify sources of operational risk and minimize them through the development of appropriate systems, controls and procedures; and have business continuity plans that allow for timely recovery of operations and fulfillment of a clearing agency's obligations.<sup>108</sup> The Commission has also noted that registered clearing agencies develop and maintain plans to assure the safeguarding of securities and funds; the integrity of automated data processing systems; the recovery of securities, funds, or data under a variety of loss or destruction scenarios; and have business continuity plans that allow for the timely recovery of operations and the fulfillment of a registered clearing agency's obligations.<sup>109</sup>

EB has rules and procedures in place to ensure that the creation of securities positions is only performed upon receipt of securities to be credited to client accounts, and that removal of these securities positions is processed without manual intervention and upon final maturity or in accordance with a corporate event. Additionally, EB represents that it reports movements in client accounts to clients on a daily basis, and that it regularly reviews its procedures and controls.<sup>110</sup> EB's risk mitigation practices and internal controls are also subject to regulatory oversight by the NBB. The Commission notes that commenters also viewed favorably EB's

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<sup>108</sup> See 12 CFR 240.17Ad-22(d)(4), (10), and (13).

<sup>109</sup> See Exchange Act Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219, 66268 (Nov. 2, 2012).

<sup>110</sup> Part of this review includes an International Standard on Assurance Engagements 3402 report, which, pursuant to the conditions set forth in Part 0, will be provided to the Commission on an annual basis.

ability to safeguard securities and funds, stating that EB is a well-known and well-regulated market infrastructure provider that operates under internationally developed standards,<sup>111</sup> and that EB has a 40-plus-year record of efficiently managing settlements and custody across numerous markets.<sup>112</sup> Finally, the conditions set forth below will allow the Commission to examine EB and monitor the U.S. Equities Clearing Agency Activities so that the Commission can assess any impact the activities may have on U.S. market participants and the U.S. securities markets. In this respect, the Commission believes that EB's operations are consistent with the Commission's current regulatory approach to the safeguarding of securities and funds related to the settlement of securities transactions, and consistent with the protection of investors, because the transfer of securities will take place via book entry at EB. As described in the Modification Application Notice, the Commission has previously stated its belief that the immobilization and dematerialization of securities and their transfer by book entry results in reduced costs and risks associated with securities settlements and custody by removing the need to hold and transfer many, if not most, physical certificates.<sup>113</sup> Accordingly, the Commission believes that approval of the Modification Application would be consistent with the public interest and the protection of investors generally, and specifically, the safeguarding of securities and funds under EB's provision of the U.S. Equities Clearing Agency Activities.

### 3. Prompt and Accurate Settlement of Securities Transactions

Congress found that the prompt and accurate clearance and settlement of securities

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<sup>111</sup> See DTC letter at 3; SIFMA letter at 3.

<sup>112</sup> See LGM letter at 1.

<sup>113</sup> See Exchange Act Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219, 66253 (Nov. 2, 2012).

transactions is necessary for the protection of investors and that inefficient procedures for settlement imposed unnecessary costs on investors.<sup>114</sup> For the reasons discussed in the Modification Application Notice and as discussed further below, the Commission believes that approval of the Modification Application would promote the prompt and accurate clearance and settlement of securities transactions and the protection of investors because EB's settlement process is consistent with prior Commission observations regarding delivery versus payment ("DVP") systems. The Commission has previously stated that DVP reduces the risk that a party would lose some or its entire principal because payment is made only if securities are delivered.<sup>115</sup> The Commission also believes that a DVP method reduces the potential that delivery of the security is not appropriately matched with payment for a security. Therefore, the Commission believes the use of a DVP method promotes the clearing agency's ability to facilitate prompt and accurate clearance and settlement.<sup>116</sup> One commenter addressed how EB eliminates the principal risk described above in noting that EB currently provides its participants with an efficient means of acquiring, holding, transferring, and pledging security entitlements by electronic book entry on its records outside the U.S., either free of or versus payment, in multiple currencies.<sup>117</sup> The Commission notes that the EB system has controls in place requiring the availability of the cash and securities before executing instructions (i.e., positioning), preventing

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<sup>114</sup> See 15 U.S.C. 78q-1(a)(1)(A), (B).

<sup>115</sup> See 77 FR at 66256.

<sup>116</sup> See id.

<sup>117</sup> See Paxos letter at 1.

settlement of the transaction if the cash and/or the securities are not available.<sup>118</sup> These rules and controls help address the principal risk inherent in settling linked obligations.

Multiple commenters noted the potential gains in efficiency to be had by U.S. Participants if EB were to expand its current services to include U.S. Equity Securities. One commenter cited EB's real-time management of collateral inventory as being integral to reducing operational risk and increasing efficiencies,<sup>119</sup> while another cited positively EB's ability to facilitate the efficient deployment of collateral at a time where new regulatory regimes significantly increase the demand for high-grade assets.<sup>120</sup> The Commission believes that EB's operations, as represented to the Commission, are conducted in a manner that is consistent with the promptness and accuracy requirements under Section 17A of the Exchange Act. This will enable the efficient transfer of assets, which helps protect investors and provides benefits to U.S. market participants.

#### 4. Maintenance of Fair Competition among Market Participants

The Commission is directed to have due regard for the maintenance of fair competition in the use of its authority under Section 17A of the Exchange Act.<sup>121</sup> One commenter stated that the Modification Application would provide a level playing field between U.S. Participants and non-U.S. participants in the types of U.S. securities they can offer as collateral in the EB-CMS,

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<sup>118</sup> In addition, EB represents that the Euroclear System is a delivery-versus-payment system, which settles instructions between clients with finality of the transfer of securities from the seller to the buyer occurring at the same time as the finality of transfer of funds from the buyer to the seller.

<sup>119</sup> See Paxos letter at 2.

<sup>120</sup> See SIFMA letter at 2.

<sup>121</sup> See 15 U.S.C. 78q-1(a)(2)(A).

noting that the use of U.S. Equity Securities as collateral within the EB-CMS is already common among EB's non-U.S. participants in the European Union.<sup>122</sup> Another commenter stated that it did not foresee other providers of collateral management services to be disadvantaged by approval of EB's Modification Application; rather, the commenter expected the Modification Application to be beneficial by expanding the options that participants and their clients have for addressing collateral demands.<sup>123</sup> The Commission notes that approval will reduce the disparity between U.S. Participant and non-U.S. participant utilization of the EB-CMS, but the Commission does not believe EB's proposal will have a direct impact on the current competitive landscape for the provision of settlement of transactions in U.S. Equity Securities for U.S. market participants more generally because Euroclear will not provide settlement for purchase and sale transactions in U.S. Equity Securities. Accordingly, the Commission believes that the Modification Application is consistent with Section 17A of the Exchange Act because it should facilitate fair competition between U.S. Participants and non-U.S. participants, consistent with the public interest, and would not prevent U.S. market participants from using other comparable services that may be (or become) available.

#### IV. Terms and Conditions of Exemption

This order grants EB an exemption from registration as a clearing agency under Section 17A of the Exchange Act to perform the Clearing Agency Activities described above. The exemption is granted subject to the conditions set forth below, which the Commission believes are necessary and appropriate in light of the statutory requirements of Section 17A. The

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<sup>122</sup> See SIFMA Letter at 2.

<sup>123</sup> See Paxos Letter at 3.

Commission is including specific conditions to this exemption designed to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions and the establishment of linked and coordinated facilities for the clearance and settlement of securities transactions. In the Modification Application, the Commission discussed the origin and purpose of each of these conditions.<sup>124</sup> The conditions are designed to promote coordination, the safeguarding of securities and funds, and fair competition among market participants. The conditions replace and supersede all conditions set forth in the Existing Exemption.

A. Continuation of Conditions Applicable to the U.S. Government Securities Clearing Agency Activities

(1) The average daily volume of eligible U.S. Government Securities processed for U.S. Participants through EB as operator of the Euroclear System may not exceed five percent of the total average daily dollar value of the aggregate volume in eligible U.S. Government Securities.

(2) EB will provide the Commission with quarterly reports, calculated on a twelve-month rolling basis, of: (a) the average daily volume of transactions in eligible U.S. Government Securities for U.S. Participants that are subject to the volume limit; and (b) the average daily volume of transactions in eligible U.S. Government Securities for all Euroclear System participants.

B. Condition Applicable to the U.S. Equities Clearing Agency Activities

EB shall provide to the Commission quarterly reports, calculated on a twelve-month rolling basis, of: (1) the average daily value of U.S. Equity Securities that are held in Collateral

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<sup>124</sup> See Modification Application Notice, supra note 5, at 61280–81.

Accounts at EB for U.S. Participants and a break-down of the general types of EB collateral agreements in respect of which such value is given as collateral; (2) the average daily value of U.S. Equity Securities that are held in EB's account at DTC relating to inventory management services; and (3) the total value, and a break-down of the general types of EB collateral agreements in respect of which such value is given as collateral, of U.S. Equity Securities that are transferred from Collateral Accounts of U.S. Participants at EB to other Securities Clearance Accounts at EB (other than IMS-Linked Accounts) pursuant to a liquidation of such collateral.

C. Operational Risk Conditions Applicable to the Clearing Agency Activities

(1) Prior to commencing the U.S. Equities Clearing Agency Activities,<sup>125</sup> EB shall demonstrate to the Commission that EB maintains written policies and procedures applicable to those systems that support or are integrally related to the Clearing Agency Activities (the "Systems") that, on an ongoing basis, are reasonably designed to:

(a) Establish a robust operational risk-management framework applicable to the Systems with appropriate systems, policies, procedures, and controls to identify, monitor, and manage operational risks;

(b) Clearly define the roles and responsibilities of EB personnel for addressing operational risk (e.g., identify a senior manager responsible for compliance with the operational conditions applicable to the Systems);

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<sup>125</sup> In the Modification Application Notice, this condition stated: "EB shall demonstrate to the Commission or its designee prior to commencing the U.S. Equities Clearing Agency Activities that EB maintains written policies and procedures applicable to those systems that support or are integrally related to the Clearing Agency Activities (the "Systems") that, on an ongoing basis, are reasonably designed to." The Commission has modified this condition to improve clarity. In addition, here and below the Commission has removed references to "or its designee" because the reference is not necessary.

- (c) Review operational policies, procedures, and controls applicable to the Systems;
- (d) Audit the Systems, and test the Systems periodically and at implementation of significant changes;
- (e) Clearly define operational reliability objectives for the Systems;
- (f) Ensure that the Systems have scalable capacity adequate to handle increasing stress volumes and achieve the Systems service-level objectives;
- (g) Establish comprehensive physical and information security policies that address all potential vulnerabilities and threats to the Systems;
- (h) Establish a business continuity plan for the Systems that addresses events posing a significant risk of disrupting the Systems' operations, including events that could cause a wide-scale or major disruption in the provision of the Clearing Agency Activities;
- (i) Incorporate the use of a secondary site in EB's business continuity plan that is designed to ensure that the Systems can resume operations within two hours following disruptive events; and
- (j) Regularly test or otherwise validate EB's business continuity plans; and identify, monitor, and manage the risks that key participants, other financial market infrastructures, and service and utility providers might pose to the Systems' operations in relation to the Clearing Agency Activities.

(2) For purposes of condition C.1, such policies and procedures shall be consistent with current information technology industry standards, which shall be comprised of information technology practices that are widely available to information technology professionals in the financial sector and issued by a widely recognized organization. EB shall inform the Commission of the information technology industry standards that EB has chosen to use, affirm

that choice on an annual basis, and provide advance notice of the use of different standards as soon as practicable.

(3) EB shall provide the Commission with an annual update on the status of the items set forth in condition C.1.

(4) EB shall establish, implement, maintain, and enforce written policies and procedures reasonably designed to ensure that the Systems operate on an ongoing basis in a manner that complies with the conditions applicable to the Systems and with EB's rules and governing documents applicable to the Clearing Agency Activities.

(5)(a) Upon EB having a reasonable basis to conclude that a disruption, compliance issue, or intrusion of the Systems that impacts, or is reasonably likely to impact, the Clearing Agency Activities has occurred (a "Systems Event"), EB shall:

(i) Take appropriate corrective action, which shall include, at a minimum, devoting adequate resources to remedy the Systems Event as soon as reasonably practical;

(ii) Notify the Commission of such Systems Event within 24 hours after occurrence;

(iii) Until such time as a Systems Event is resolved and EB's investigation of the Systems Event is closed, provide updates pertaining to such Systems Event to the Commission on a regular basis;

(iv) Within 48 hours after the occurrence of a Systems Event or where EB reasonably determines that such deadline cannot be met and so notifies the Commission, promptly thereafter, submit an interim written notification pertaining to such Systems Event to the Commission containing: (A) a detailed description of: the relevant discovery and duration times, detection, root cause, and remedial actions taken or planned regarding the Systems Event (to the extent known at report time); EB's assessment of the entities (including types of market participants)

and EB services affected by the Systems Event; EB's assessment of the impact of the Systems Event on the Participants; and any other pertinent information known by the EB about the Systems Event; and (B) a copy of any information disseminated to EB's U.S. Participants in accordance with EB's notification practices regarding the Systems Event;

(v) Within ten business days after the occurrence of a Systems Event, or where EB reasonably determines that such deadline cannot be met and so notifies the Commission, promptly thereafter, submit a written final report regarding the matters covered in the interim report required under (iv) above to the Commission; and

(vi) For Systems Events characterized as "Bronze level" events (i.e., a Systems Event in which the incident is clearly understood, almost immediately under control, involves only one business unit and/or entity, and is resolved within a few hours), in lieu of the reporting in (i) through (v) above, provide on a quarterly basis an aggregated list of Bronze level events.

(b) As used herein: (i) a "disruption" means an event in the Systems that disrupts, or significantly degrades, the normal operation of the Systems in relation to the Clearing Agency Activities; (ii) a "compliance issue" means an event at EB that has caused any System to operate in a manner that does not comply with the applicable conditions or EB's rules and governing documents applicable to the Clearing Agency Activities; and (iii) an "intrusion" means any unauthorized entry into the Systems in relation to the Clearing Agency Activities.

(6) EB shall, within 30 calendar days after the end of each quarter, submit to the Commission a report describing completed, ongoing, and planned material changes to the Systems that support or are related to the Clearing Agency Activities during the prior, current, and subsequent calendar quarters, including the dates or expected dates of commencement and

completion. EB shall establish reasonable written criteria for identifying a change to the Systems as material and report such changes in accordance with such criteria.

(7) EB shall provide the Commission with: (a) annually, the audited control report made available to EB's Participants prepared in accordance with internationally accepted standards for assurance reports on controls at a service organization (such as the International Standard on Assurance Engagements (ISAE) Standard No. 3402); (b) annually, copies of those portions of any annual control report provided by EB to its primary Belgian regulator that describes controls applicable to the Systems as used to support or in relation to the Clearing Agency Activities; and (c) copies of agendas, reports and presentation materials relating to the capacity, integrity, resiliency, availability, and security or compliance of the Systems that are provided by EB or its primary Belgian regulator to any committee of regulators that implements the memorandum of understanding among regulators of Euroclear Group's CSD entities that provides for the coordinated and common oversight and supervision of the Euroclear Group.

(8) EB shall make, keep, and preserve at least one copy of all documents relating to its compliance with the operational risk conditions; keep all such documents for a period of not less than five years, the first two years in an easily accessible place (which may be located in the European Union); and upon request of the Commission, promptly furnish to the possession of the Commission copies of any such documents.

D. Additional Conditions Applicable to the Clearing Agency Activities

(1) EB shall provide to the Commission its annual audited financial statements prepared by competent independent audit personnel.

(2) EB shall notify the Commission of any material changes to any service agreement between EB and any other entity that is performing Clearing Agency Activities on behalf of EB if such changes are reasonably expected to materially affect the Clearing Agency Activities.

(3) EB will notify the Commission (a) promptly following termination of any U.S. Participant as a participant in the Euroclear System, (b) promptly following the liquidation by EB of any securities collateral pledged by a U.S. Participant to EB to secure an extension of credit made through the Euroclear System, and (c) promptly following EB becoming aware of the institution of any proceedings to have a U.S. Participant declared insolvent or bankrupt, and will respond to Commission requests for information about any U.S. Participant about whom the Commission has financial solvency concerns, including, for example, a settlement default by a U.S. Participant.

(4) EB shall annually provide to the Commission a report describing: (a) material changes to the representations made by EB in support of the approval of this Order that would not otherwise require amendment of EB's application for exemption on Form CA-1 in accordance with these conditions; (b) the functioning of EB's policies and procedures for monitoring its own compliance with the conditions of this order regarding the Clearing Agency Activities (and the compliance of any affiliated or third-party service provider referred to in condition D.2); and (c) the management by EB of any conflicts of interest of such affiliated or third-party service provider that EB becomes aware have arisen since the prior report with respect to the performance of the Clearing Agency Activities.

(5) EB shall keep records relating to the Clearing Agency Activities regarding settlement details, account details, service agreements, and service notices sent to U.S. Participants pertaining to the operation of the Clearing Agency Activities, retain such records for a period of

not less than five years, the first two years in an easily accessible place (which may be located in the European Union), and upon request of any representative of the Commission promptly furnish, or require its service providers to furnish, copies thereof to the possession of such representative.<sup>126</sup>

(6) EB shall respond to and require its service providers to respond to a request from the Commission for additional information relating to the Clearing Agency Activities and provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment), records, and personnel related to the Clearing Agency Activities. The request for information shall be made and the inspections shall be conducted solely for the purpose of reviewing the Clearing Agency Activities' operations and compliance with the federal securities laws and the terms and conditions in any order exempting EB from registration as a clearing agency with regard to the Clearing Agency Activities.

(7) EB shall file with the Commission amendments to its application for exemption on Form CA-1 if it makes any material change to the Clearing Agency Activities or any change materially affecting the Clearing Agency Activities as summarized in the relevant exemption order, EB's amended Form CA-1 or in any subsequently filed amendments to its Form CA-1 that would make such previously provided information incomplete or inaccurate.

E. Modifications to Exemption

EB is required to file with the Commission amendments to its application for exemption on Form CA-1 if it makes any material change affecting the Clearing Agency Activities—as

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<sup>126</sup> The Commission has modified this condition to clarify that, upon request of any representative of the Commission, EB shall promptly furnish, or require its service providers to promptly furnish, copies of the records described in the condition to the possession of such representative.

summarized in this order, in its application on Form CA-1 dated May 9, 2016, or in any subsequently filed amendments to its application on Form CA-1—that would make such previously provided information incomplete or inaccurate.

In addition, the Commission may modify by order the terms, scope, or conditions of EB's exemption from registration as a clearing agency if it determines that such modification is necessary or appropriate in the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. Furthermore, the Commission may limit, suspend, or revoke this exemption if it finds that EB has violated or is unable to comply with any of the provisions set forth in this order if such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.

#### V. Conclusion

The Commission believes that the Modification Application demonstrates that EB will have sufficient operational capabilities to facilitate prompt and accurate collateral management services and to support the establishment of linked and coordinated facilities for the settlement of obligations under its collateral management services in support of securities transactions. The Commission also notes that EB's exemption will be subject to conditions that are designed to enable the Commission to monitor EB's operational capacity and safeguards, corporate structure, and ability to operate in a manner to further the purposes of Section 17A of the Exchange Act. Further, the conditions include a robust set of reporting requirements that will allow the Commission to monitor the growth and development of EB's exempted clearing agency activities so that the Commission will be well positioned to evaluate whether and when any modifications to the terms and conditions set forth above are necessary. Therefore, for the

reasons discussed throughout this order, the Commission finds that the Modification Application is consistent with the public interest, the protection of investors, and the purposes of Section 17A of the Exchange Act.

IT IS HEREBY ORDERED, pursuant to Section 17A(b)(1) of the Exchange Act, that the application for a modification of EB's exemption from registration as a clearing agency under Section 17A(b)(1) of the Exchange Act filed by EB on May 9, 2016 (File No. 601-01) be, and hereby is, approved within the scope described in this order and subject to the terms and conditions contained in this order.

By the Commission.

Brent J. Fields  
Secretary

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